

✓
Internal Revenue Service
memorandum

TL-N-1689-90
Br2:ORPirfo

date:

FEB 23 1990

to:

District Counsel, San Diego CC:W:SD
Attn: William B. Lowrance

from:

Assistant Chief Counsel (Tax Litigation) CC:TL

subject:

[REDACTED]

This responds to your request for tax litigation advice, dated November 27, 1989, concerning the above-referenced taxpayers.

ISSUES

1. Whether [REDACTED] can carryback to prior years' [REDACTED] consolidated returns ([REDACTED]) a net operating loss (NOL) attributable to its former subsidiary, [REDACTED], which arose in a later year in which [REDACTED] filed consolidated returns with another group (i.e., [REDACTED]) after [REDACTED] had previously carried back that same NOL to two other [REDACTED] consolidated years ([REDACTED] and [REDACTED]) and to one of [REDACTED]'s separate return years ([REDACTED]) by way of a tentative carryback refund adjustment under § 6411.

2. Whether the Internal Revenue Service should unilaterally "correct" the carryback of the [REDACTED] NOL attributable to [REDACTED] to apply it to prior consolidated return years of [REDACTED] other than those years to which it had already been applied.

FACTS

The facts as stated herein were chiefly recited in your request for advice and were further developed from a review of the attachments to that request and the [REDACTED] refund suit complaint (discussed infra) and through our telephone conferences.

From [REDACTED] through [REDACTED], [REDACTED] was a subsidiary of [REDACTED], as well as other subsidiaries of [REDACTED], filed consolidated returns for these years with [REDACTED]. In [REDACTED], pursuant to I.R.C. § 355, [REDACTED] was spun off. [REDACTED] filed separate tax returns for [REDACTED] and [REDACTED] ([REDACTED], [REDACTED]). [REDACTED] had taxable income for the [REDACTED] separate year. On [REDACTED] [REDACTED] was acquired by [REDACTED]

09275

(). then filed its final separate return for . was included in the consolidated return of for .

incurred an NOL for . 's share of that NOL was approximately \$. Pursuant to I.R.C. § 6411, timely filed two Form 1139 applications for tentative carryback adjustments. One Form 1139 carried back \$ and \$ of the NOL to the group consolidated returns of and , respectively. The second Form 1139 carried back \$ into 's separate return year, thereby absorbing the entire balance of the NOL. On the basis of those applications, refunds were made to , as the common parent, for and and directly to for the separate year . See Treas. Reg. § 1.1502-78(c).

During the aforementioned tentative refund process, as a separate matter, 's tax returns for through were being examined. That examination led to various adjustments, including carrybacks to the years through . disagreed with the examination's findings and filed a protest requesting an Appeals conference. During the subsequent Appeals' consideration, raised the contention that an error had been made by in its calculation of its bad debt reserve in and that this error ran forward and affected the subsequent years through . The bad debt reserve had been overstated originally and the correct computation increased taxable income for through . Correction of the bad debt reserve error would thus result in earlier consolidated years that would then be available to absorb the NOL. On these grounds, contends that 's NOL carryback should have been applied to the earlier through consolidated years rather than to just the (CRY), (CRY), and (SRY) years. Appeals viewed this contention to be a new technical issue and refused to consider it.

At the time of 's tentative carryback adjustment application, the putative bad debt reserve error for 's earlier years had as yet not been discovered. Under I.R.C. § 172(b)(1)(M) (now redesignated (L)), was entitled to carryback the NOL to the period of the taxable years preceding the year of the NOL. The NOL is carried back to the earliest year under § 172(b)(1) in which the loss may be absorbed. Any excess loss is then used in successive subsequent years where taxable income is available. I.R.C. § 172(b)(2). Thus, carried back the NOL correctly on the basis of the income information that was available to it at the time of its tentative refund application.

After the Appeals conference, the examination of the [REDACTED] through [REDACTED] years was concluded and certain proposed adjustments were made with regard to each of the [REDACTED] through [REDACTED] returns of [REDACTED]. In response to notice and demand, [REDACTED] paid the amounts due for these years, plus interest, in full on or about [REDACTED]. On [REDACTED], [REDACTED] filed claims for refund with the Fresno, California Service Center for these taxable years ([REDACTED]-[REDACTED]). The claims for refund represented only a portion of the amounts [REDACTED] had paid. These claims for refund for the [REDACTED] through [REDACTED] years were based on various contentions; however, the claims did not present the [REDACTED] NOL "erroneous" carryback issue. The claims were denied in full by the Service on [REDACTED]. On [REDACTED], [REDACTED] filed a refund suit in the Southern District of California on the basis of the previously-denied claims. The refund suit complaint does not vary from the 1120X claims in that, once again, the [REDACTED] NOL carryback issue is not raised.

DISCUSSION

I.R.C. § 6411(a) provides that a taxpayer may file an application for a tentative carryback adjustment of the tax for a prior taxable year affected by an NOL carryback under § 172(b). If the corporation seeking the tentative carryback adjustment made a consolidated return, either for the year of the NOL or for the prior taxable year affected by the NOL, then § 6411(c) mandates that § 6411 should apply only to the extent and subject to such conditions, limitations, and exceptions as may be prescribed by the regulations. As indicated by the facts, therefore, [REDACTED]'s tentative carryback applications are controlled by § 6411(c). The pertinent provisions here are Treas. Regs. §§ 1.1502-78 and -79. See also Treas. Regs. §§ 1.1502-1(e) and -21(c).

Under Treas. Reg. § 1.1502-78(a), if a loss can be carried back from a former member's separate return year to a consolidated return year, the application for tentative carryback adjustment must be filed by the separate corporation to which such loss was attributable. A "separate return year" includes a taxable year where, like [REDACTED] in [REDACTED], the corporation joins in the filing of a consolidated return by another group. Treas. Reg. § 1.1502-1(e). Thus, as outlined in the Facts section above, [REDACTED] complied with the regulations' filing requirements. Similarly, on the basis of the presumed accurate income information for relevant prior consolidated years as known to [REDACTED] (and to [REDACTED]) at the time of the filing and refund, the NOL was carried back to the correct years and appropriately limited by the separate-return-limitation-year regulation. See Treas. Reg. § 1.1502-21(c).

█████ apparently contends that irrespective of what seemed to be the correct consolidated years for carryback at the time of the § 6411 application, and notwithstanding that a refund has in fact been made directly to ██████ for the ██████ separate return, the "correct" years should now be used to apply the carryback (i.e., beginning with the ██████ CRY). Presumably, in practical terms, this means that the NOL carryback attributable to ██████ for which a refund was received by ██████ for the ██████ separate year would instead be entirely used up in the earlier ██████ group consolidated years. Consequently, as the common parent, ██████ rather than ██████ would receive the benefit of the ██████ NOL carryback to those earlier ██████ consolidated years. 1/ See Treas. Reg. §§ 1.1502-77(a), 1.1502-78(c), Ex. 3.

As stated previously, while ██████ has made claims for refund for the ██████ through ██████ taxable years and has filed suit in district court on the subsequent denial of those claims, it has not, thus far, included these ██████ NOL issues in those claims or in the refund suit complaint. Presumably, the "██████ NOL" matter is now before Examinations; however, since notices and demands for ██████ through ██████ have already issued, been paid, and now sued upon, it is unclear how or whether the ██████ issues will surface. 2/ As we have discussed in our phone conversations, it is uncertain whether ██████ currently even "expects an answer" from the Service as to the ██████ NOL question.

1/ How the parent's refund would be credited or forwarded by the common parent to members of the group, if at all, and ultimately passed on to ██████ in this case is not addressed by the Code or regulations. Arguably, it is not the Service's concern. While Treas. Reg. § 1.1552-1 provides rules for determining the respective earnings and profits of an affiliated group, there is no similar provision for determining a member's share of any refund made to a common parent. ██████, for its part, has not proposed any "correction" of the tentative carryback adjustment.

2/ Since the permitted time period (12 months from the NOL) in which to file an application for tentative carryback adjustment of the ██████ NOL has lapsed, see I.R.C. § 6411(a), any other refund claim for any or all ██████ consolidated years ██████ would be made by the common parent, ██████, as agent for the group. See Treas. Reg. 1.1502-77(a). Any such refund would be paid to ██████. Id.

Because of the uncertainty regarding [REDACTED]'s communications on this issue, it should be noted as a possibility that any inquiry or request from [REDACTED] regarding the [REDACTED] NOL issue to the Service might be construed as an adequate "informal" claim for refund which would be sufficient to establish jurisdiction for another separate refund suit under § 7422. See National Forge & Ordnance Co. v. U.S., 151 F. Supp. 937 (Ct. Cl. 1957). In Newton v. U.S., 163 F. Supp. 614, (Ct. Cl. 1958), the Court stated that a letter which specifically protests an assessment could be found to be an adequate claim for refund. Further, an informal claim may be "perfected" by the filing of an amended claim even after the end of the limitations period. See U.S. v. Memphis Cotton Oil Co., 288 U.S. 62 (1932); but see Treas. Reg. 5.6411-1(f) (application for tentative refund under I.R.C. § 6411(d) is not a claim for refund).

Since § 6511(d)(2) makes special allowance for an extended limitation period for claim of refund when an NOL is involved, 3/ the [REDACTED] NOL issue may be raised eventually by amendment to the complaint in the currently pending district court action or by a later separate suit. While a final judgment in a tax refund suit is normally res judicata with respect to a taxpayer's liability for the taxes and the taxable periods in issue, and a later claim with respect to those periods would be barred (see Chicago Junction Railways v. U.S., 10 F.Supp 156 (Ct. Cl. 1935)), when an NOL is involved the taxpayer could arguably still reopen the year by operation of § 6511(d)(2), but only for the purpose of raising the carryback.

[REDACTED] might wait until the current refund suit is resolved and then file a refund claim and suit based solely on carrying the [REDACTED] NOL back to some or all of the [REDACTED] to [REDACTED] years. If this were to occur, offsets should be made to the extent the earlier refunds to [REDACTED] were rendered inappropriate. To the extent the [REDACTED] years [REDACTED] and [REDACTED] were not involved in such a suit, then deficiencies would have to be asserted for

3/ Section 6511(d)(2)(A) allows a claim for refund for a year affected by an NOL carryback to be made up to six months after the period in which an assessment can be made for the year in which the NOL arose. See § 6511(c)(1). Thus, since the [REDACTED] year remains open (by execution of a Form 872-A), pursuant to Sec. 6511(c), the [REDACTED] years [REDACTED]-[REDACTED] would appear to be open for refunds based on a carryback from [REDACTED] even after the current refund suit is resolved so long as the 872-A for [REDACTED] remains effective.

these nonsuit years to recover the prior erroneous refunds and of course a deficiency would have to be asserted against [REDACTED]'s [REDACTED] year to protect the revenue. 4/

[REDACTED]'s [REDACTED] year remains open for assessment of a deficiency by virtue of the [REDACTED] execution ([REDACTED]'s new common parent) of a Form 872-A for [REDACTED]. If the [REDACTED] refund suit complaint were ultimately amended to include the [REDACTED] NOL issue, then a statutory notice of deficiency should be served on [REDACTED] for [REDACTED]. Section 6501(h) makes such a Government remedy available since it provides that a deficiency attributable to the carryback of an NOL may be assessed at any time before the expiration of the assessment period for the year in which the NOL arose. Therefore, since the NOL year ([REDACTED]) remains open, the earlier carryback year ([REDACTED]) is also open under § 6501(h). Similarly, with regard to the [REDACTED] and [REDACTED] years, those years would also remain open under § 6501(h). Thus, if [REDACTED] raises the [REDACTED] NOL in a separate refund claim/suit and depending upon how much of the [REDACTED] NOL is used up in [REDACTED] through [REDACTED], the Service could recover the refund it has made for [REDACTED] and [REDACTED], if necessary, either by asserting an offset in such a future refund suit or by asserting a deficiency against [REDACTED] for [REDACTED] and [REDACTED] if those years are not involved in such a future refund claim/suit.

This would protect the Government's recovery of the [REDACTED] "erroneous" refund if it were ultimately ruled, as [REDACTED] asserts, that the NOL should not have been applied to the [REDACTED] year. Hence, [REDACTED]'s [REDACTED] year should be left open until such time as the pending [REDACTED] refund suit is finally adjudicated or [REDACTED] formally waives the [REDACTED] NOL carryback issue (e.g., by closing agreement or other means).

In sum, the taxpayer could avail itself of § 6511(d) for purposes of filing a subsequent refund claim/suit as to the [REDACTED] through [REDACTED] years and, if [REDACTED] were ultimately successful on reapplying the [REDACTED] NOL to those years, the Government may still assert a deficiency or offset for the [REDACTED] [REDACTED] and [REDACTED] years and a deficiency for the [REDACTED] [REDACTED] year pursuant to 6501(h).

4/ Generally, with respect to an erroneous carryback allowance, the Service has the option of issuing a notice of deficiency, bringing suit for an erroneous refund or assessing a deficiency as a mathematical error. See Midland Mortgage Co. v. Commissioner, 73 T.C. 902 (1980).


RECOMMENDATION

In the event that [REDACTED] formally seeks to "reapply" the [REDACTED] NOL of [REDACTED] to its pre-[REDACTED] tax years, in order to protect the revenue, the Service should both disallow that claim and serve a notice of deficiency on [REDACTED] for its [REDACTED] year and a deficiency or offset on [REDACTED] for the [REDACTED] and [REDACTED] years.

Since the bad debt reserve "error" issue has not been fully developed and there remain at least some questions with regard to whether [REDACTED] intends to pursue the matter, the Service should not unilaterally "correct" the [REDACTED] NOL carryback.

MARLENE GROSS

By:


ALFRED C. BISHOP, JR.
Chief, Branch No. 2
Tax Litigation Division

Attachment:
Legal File